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In the Supreme Court of the United States

OCTOBER TERM, 1978

STATE OF MONTANA, ET AL., APPELLANTS

v.

UNITED STATES OF AMERICA

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MONTANA

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the district court (J.S. App. 5-35) is reported at 437 F. Supp. 354.

JURISDICTION

The judgment of the district court (J.S. App. 1-4) was entered on October 18, 1977. The notice of appeal to this Court (J.S. App. 36-37) was filed on December 15, 1977 (J.S. 2). The appeal was dock-

eted on February 13, 1978, and probable jurisdiction was noted on May 22, 1978 (A. 187).

This is a direct appeal from a judgment of a three-judge district court (1) declaring that Title 84, Chapter 35, Revised Codes of Montana, 1947, as amended, and the rules and regulations promulgated thereunder, violate the Supremacy Clause of the United States Constitution insofar as they apply to the United States of America, its contractors, subcontractors and those with whom it deals; and (2) permanently enjoining the enforcement of that statute against those persons (J.S. App. 1-3).[1] The jurisdiction of this Court is conferred by 28 U.S.C. 1253, which authorizes a direct appeal from an order granting permanent injunction in any civil action required by any Act of Congress to be heard and determined by a district court of three judges. Pursuant to 28 U.S.C. 2281, a permanent injunction restraining the enforcement of a state statute on the ground of unconstitutionality can only be granted by a three-judge district court.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI of the United States Constitution provides:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme law of the land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

[1] In its judgment, the court ordered that the federal government's claim for refund of the license fee and gross receipts tax be determined by a single-judge district court (J.S. App. 3).

The relevant provisions of the Montana Contractors' Gross Receipts Tax (Revised Codes of Montana, 1947, as amended, Title 84, Chapter 35, Section 84-3505, *et seq.*, 1975 Cum. Supp.) are set forth at J.S. App. 38-48.

QUESTIONS PRESENTED

1. Whether the Montana gross receipts tax imposed upon contractors with respect to government contracts, which in actual operation burdens the federal and not the state government, violates the Supremacy Clause of the Constitution by discriminating against the federal government and those with whom it deals.

2. Whether the decision of the Montana Supreme Court in *Peter Kiewit Sons' Co.* v. *State Board of Equalization*, 161 Mont. 140, 505 P.2d 102, bars the United States from challenging the constitutionality of the Montana tax in this case.

STATEMENT

1. Section 84-3505, Revised Codes of Montana (1975 Cum. Supp.) (J.S. App. 40-41) imposes upon public contractors a tax equal to one percent of gross receipts derived from public construction contracts performed in Montana for federal, state or

local governments.[2] The statute defines "public contractor" as "any person who submits a proposal, or enters into a contract, for performing all public construction work in the state with the federal government, state of Montana, or with any * * * city or town council * * * or with any public board, body, commission or agency, authorized to let or award contracts for any public work where the contract cost * * * exceeds $1,000" (Section 84-3501(b), Revised Codes of Montana (1975 Cum. Supp.)) (J.S. App. 38, 83-84).

Private contractors, *i.e.*, those not engaged in work on behalf of any government, are not subject to the gross receipts tax. Nor are the gross receipts of "public contractors" derived from private work subject to the tax (J.S. App. 40-41, 90). Thus, receipts from construction work performed for federal, state or local governments in Montana are subject to a tax that receipts from private work are not (J.S. App. 84, 88, 90; A. 25).

A contractor may credit against the gross receipts tax the taxes paid on his personal property used in

[2] Prior to June 30, 1975, the one percent tax was imposed with respect to each contract upon the gross receipts of the prime contractor and of each subcontractor. Thus, the cumulative gross receipts tax could exceed one percent of the total contract price. The statute was amended to provide that the total amount of the gross receipts tax for any single contract (including subcontracts) could not exceed one percent. Montana Session Laws of 1974, c. 180, Section 1 (J.S. App. 40-41, 89).

There is also an annual license fee of $10 to $200 (depending upon the dollar amount of construction the license authorizes) (J.S. App. 40).

his contracting business in Montana. He may credit the balance of the gross receipts tax against the Montana individual income tax or the corporate income tax (Section 84-3514, Revised Codes of Montana (1975 Cum. Supp.) (J.S. App. 47-48)). The credits against the individual income tax or the corporate license tax may be used within a five-year period (Sections 84-1508.2(2), 84-4920 and 84-4922, Revised Codes of Montana (1975 Cum. Supp.)). The effective rate of the gross receipts tax thus varies among public contractors because of differences in their personal property and income taxes, but it averages approximately one-half of one percent of gross receipts (J.S. App. 11-12, 87-88, 90).[3] The tax is normally passed on by the federal contractor to the federal government and thus increases the cost of construction for federal projects (Pltf. Ex. 1, A. 80-81; A. 86, 98-108, 112-117, 164).[4] Since

[3] As of July 7, 1975, the State of Montana had collected $12,839,878.45 in gross receipts taxes and had retained $5,658,437.29 after all credits had been taken (J.S. App. 92). Federal projects account for at least 65.8 percent of the amount of gross receipts tax collected and for at least 57.2 percent of the balance retained after credits. However, these figures do not include all federal projects. Accordingly, the percentage of the tax collected from contractors on federal projects retained by the state from these projects would be higher than 57.2 percent (I-Tr. 169-171; Pltf. Ex. 7, p. 4).

[4] The State actually refunds the credit for personal property taxes because the gross receipts tax is paid before the amount of the credit is determined. The Department of the Army requires that its contractors return these refunds generated by Army contracts. The other federal agencies do not include this provision in their contracts (A. 106, 133, 136, 161, 164-165).

the services performed by contractors on behalf of governments and private parties are comparable, the only essential difference between a federal construction project and a private construction project is that the federal government bears a higher cost on account of the one percent gross receipts tax (J.S. App. 16; A. 108-111, 181-183).

A contractor's bid for a state construction project would not be substantially different from his bid for an identical federal construction project (A. 101). The actual cost of the construction project to the federal government is, however, greater than the actual cost of the identical construction project to the state government. This difference reflects the fact that while the federal contractor pays the tax and passes it on to the federal government, the state withholds the one percent tax and never actually pays it over to the contractor unless local property tax credits are applicable (A. 86-88, 90-91, 98-99, 102, 130-155, 171-172).

2. The United States brought this action in the United States District Court for the District of Montana against the State of Montana, its Department of Revenue and its Director of Revenue. It sought, *inter alia*, (1) a declaratory judgment that the imposition of the gross receipts tax upon the United States, its contractors, subcontractors or those with whom it dealt violated the Supremacy Clause of the United States Constitution, (2) a permanent injunction against imposing the tax on those persons, and (3) a refund of the taxes collected from those persons (J.S. App. 80-81).[5] The case was continued on stipulation pending resolution in the Montana state courts of *Peter Kiewit Sons' Co.* v. *State Board of Equalization*, 161 Mont. 140, 505 P.2d 102 (J.S. App. 49-58).

In *Peter Kiewit Sons' Co.* v. *State Board of Equalization*, 161 Mont. 140, 505 P.2d 102 (*Kiewit #1*) (J.S. App. 105-123), the contractor, in litigation financed and directed by the United States, sought a refund of the gross receipts tax that it had paid on amounts received under its contract with the Department of the Army, contending that the tax unconstitutionally discriminated against those who dealt with the United States.[6] Under its contract with the Department of the Army, Kiewit was prohibited from taking advantage of the credit provisions of the gross receipts tax.[7] The Montana Su-

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[5] The United States also sought to have the license and regulatory provisions of Title 84, Chapter 35, Revised Codes of Montana, 1947, as amended, declared unconstitutional and to enjoin their enforcement against contractors dealing with the United States (J.S. App. 78, 80). The Montana Supreme Court in *Peter Kiewit Sons' Co.* v. *State Board of Equalization*, 161 Mont. 140, 151-153, 505 P.2d 102, 109-110, determined that the regulatory provisions of the Montana Act were not applicable to the United States, its contractors or its subcontractors (J.S. App. 7, n. 2, 78-79, 121-122).

[6] The United States appeared as *amicus curiae* in the Supreme Court of Montana in *Kiewit #1* (J.S. App. 86).

[7] This contract provision, and the policy embodied in it, have since been abandoned. After 1971, the federal government has required its contractors to take advantage of all credits, including credits available for prior periods (J.S. App. 11, 91).

preme Court held, *inter alia*, (1) that the gross receipts tax was a revenue enforcing measure, (2) that but for the prohibition in the federal contract against using the credits, Kiewit could have recovered most if not all of the gross receipts tax paid (J.S. App. 111-113),[8] and (3) that the tax did not unconstitutionally discriminate against contractors dealing with the United States. In the Montana Supreme Court's view, the legislative classification between public and private contractors was reasonable because public contractors were required to comply with certain safety precautions (J.S. App. 117-120). Moreover, the court rejected the contractor's claim of discrimination against the United States because it concluded that the Montana tax treats the federal government in the same manner as the State of Montana treats itself (J.S. App. 121). Accordingly, the court rejected Kiewit's claim to a refund of the gross receipts tax refund (J.S. App. 85-86, 105-123).

During the period that the present case was continued, the Montana Supreme Court decided *Peter Kiewit Sons' Co.* v. *Department of Revenue*, 166 Mont. 260, 531 P.2d 1327 (*Kiewit #2*), which differed from *Kiewit #1* only in adjudicating the

[8] Kiewit incurred a personal property tax liability of $35,803.22 on its heavy equipment. It sought a refund of gross receipts taxes of $8,726.47. If it had claimed the personal property tax credit, it would have been entitled under Montana law to a refund of that latter amount (J.S. App. 109, 112).

amounts of gross receipts taxes due at different times. The Montana Supreme Court held that its decision in *Kiewit #1* was *res judicata* on the constitutional challenge to the gross receipts tax (J.S. App. 124-130).[9]

After the decision in *Kiewit #2*, the present case was heard on the merits by a three-judge district court. The State of Montana contended that the imposition of the gross receipts tax upon contractors dealing with the United States did not violate the Supremacy Clause of the Constitution because the tax was also imposed upon contractors dealing with the state, and that the United States was bound by the decision of the Montana Supreme Court in *Kiewit #1* (J.S. App. 9-10, 20-35, 94-100). The district court held, with one judge dissenting, that the Montana gross receipts tax upon contractors dealing with the United States violated the Supremacy Clause of the Constitution because it discriminated without justification against those contractors and in favor of contractors dealing with private entities, and imposed upon the United States costs greater than those borne either by private entities or by the State of Montana (J.S. App. 8-9, 13-17, 92-94). The district court further held that the United States was not bound by the *Kiewit* litigation (J.S. App. 15).

[9] The parties did not agree to continue the present case pending a decision in *Kiewit #2*. The government did not appear as *amicus* in that case.

SUMMARY OF ARGUMENT

I.

This Court has consistently held that "a tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the Government or those with whom it deals" (*United States* v. *City of Detroit*, 355 U.S. 466, 473). This proscription is inherent in the federal government's immunity from state taxation under the Supremacy Clause. See, *e.g.*, *McCulloch* v. *Maryland*, 4 Wheat. 316; *United States* v. *County of Fresno*, 429 U.S. 452, 463-464; *Phillips Chemical Co.* v. *Dumas School Dist.*, 361 U.S. 376, 385-387; *Moses Lake Homes* v. *Grant County*, 365 U.S. 744, 751.

In *County of Fresno*, the Court upheld a county tax, authorized by state law, on the possessory interests of those who occupy federally-owned houses on tax-exempt government land. This tax corresponded to the tax which California imposed on the owners of private land, which was presumably reflected in the rent paid by private lessees. In upholding the constitutionality of the tax upon federal lessees, the Court reaffirmed the teaching of *McCulloch* that the states cannot impose taxes bearing on the federal government but that taxes bearing indirectly on both private and federal interests are subject to a "political check against abuse" and are therefore permissible (429 U.S. at 458). As the Court observed, "the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the

tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the State" (footnote omitted) (429 U.S. at 462). If the tax had not been imposed on private lessees, it would have been invalid as to the federal lessees, for it then would have been discriminatory. *Id.* at 463 n. 11, 465.

The district court correctly held that the Montana gross receipts tax discriminated against the United States and those with whom it dealt, and therefore violated the Supremacy Clause of the Constitution. The tax at issue is imposed upon gross receipts derived from public construction contracts performed in Montana for federal, state or local governments. Thus, the tax is not "imposed equally on other similarly situated constituents of the State" because it is not imposed on private contractors. Under the principles announced in *McCulloch* and reaffirmed in *County of Fresno*, the tax cannot pass constitutional muster.

Contrary to the appellants' argument, the fact that the tax is also imposed on contractors for the state does not save it from unconstitutionality. The payment of the tax by state contractors is irrelevant because such payments simply reflect the transfer by the state from its left pocket (the contracting office) to its right pocket (the tax collector). Thus, if the tax were imposed on private contractors, the tax would be nondiscriminatory because there would be a "political check" against oppressive taxes that would serve to protect the federal government. Since

the state legislature would presumably not impose oppressive taxes on its citizens, any tax that puts the federal government to the same burden as the state's citizens would be constitutional. However, if, as in the instant case, private contractors are exempt from the tax, there is no check to prevent the legislature from raising the tax to oppressive levels. Its citizens will not protest and the state, though it transfers larger amounts of money from pocket to pocket, in the end pays nothing.

It is therefore evident that the imposition of the tax on private contractors is the only real protection that the federal government has against discrimination. Once that check is eliminated, as in the instant case, the federal government stands alone as a true taxpayer to the state. Appellants' claim that its own contractors must also pay the higher tax is illusory; whatever the contractors pay to the state is reimbursed by the state and, no matter how high the tax, the state merely pays it from one pocket to another.

II.

The district court also correctly held that the federal government was not barred from litigating the merits by the decision in *Kiewit #1*, a case that one of its contractors brought in the Montana state courts. Neither the rule of *England* v. *Medical Examiners*, 375 U.S. 411, nor the doctrine of collateral estoppel, foreclosed the federal court judgment.

England held that parties who initially present their federal claims to a federal court cannot litigate those issues in that court where (1) the federal court abstains and sends the parties to state court for a resolution of state law grounds, (2) those parties "freely and without reservation" litigate all their claims in the state courts, (3) the parties in each action are identical, and (4) the state court has jurisdiction over the parties. These conditions are not met here.

First, the district court never invoked the doctrine of abstention. That doctrine permits a federal court to decline to exercise its jurisdiction in cases presenting a federal constitutional issue that might be mooted by a state court determination of pertinent state law, or where there is a difficult question of state law that is best resolved by a state court. It is therefore not applicable to this case which involves only a constitutional claim of immunity from taxation. The continuance in this case can neither be characterized as, nor analogized to, abstention. The parties to this litigation merely agreed to continue the case while the state courts considered *Kiewit #1*, a separate action brought by a contractor, in which the federal government appeared as *amicus curiae*.

Second, in agreeing to the continuance, the United States never "freely and without reservation" submitted its claims to the state court. The state court thus never acquired jurisdiction over the federal government and the federal government is not bound by the judgment in that case. Indeed, in this

action, the federal government sought a ruling as to the effect of the tax with respect to all of its contracts. The *Kiewit* case involved only one type of contract—and that one no longer effective. The rule in *England* therefore did not prevent the district court from reaching the merits of the dispute here.

Nor does the doctrine of collateral estoppel bar the United States from litigating the merits of its claim. That doctrine "must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged." *Commissioner* v. *Sunnen*, 333 U.S. 591, 599-600.

Here, the controlling facts changed between *Kiewit #1* and the instant case. The contract at issue in *Kiewit #1* forbade the contractor from claiming the credit and refund provisions of the gross receipts tax. This provision is no longer applicable in the contracts involved in this litigation.

The decision in *Kiewit #1*, moreover, did not determine the issue here. Because of the amount of heavy equipment that Kiewit employed in Montana, it was not established that the gross receipts tax here in question would have imposed any financial burden upon the contractor. Had it claimed the credit, it appeared that Kiewit's personal property tax would have eliminated all of the public contractor's gross receipts tax. Inded, the Montana Supreme Court proceeded upon the assumption that there might in all cases be "a total washout of the 1% gross receipts payments" (J.S. App. 109, 111-113). Though Kiewit might have been relieved of all of the public contractor's tax had it claimed the available credit, and though the Supreme Court of Montana was uncertain of the ultimate fiscal impact of the tax, the record in this case establishes that with respect to its contractors, the effective rate of the tax borne ultimately by the United States, after taking all credits available, will be approximately one-half of one percent of gross receipts (J.S. App. 11, 87-88). Thus, the factual assumption upon which *Kiewit #1* rests is lacking in this case.

ARGUMENT

I.

THE MONTANA CONTRACTORS' GROSS RECEIPTS TAX VIOLATES THE CONSTITUTIONAL IMMUNITY OF THE UNITED STATES FROM STATE TAXATION BECAUSE IT DISCRIMINATES AGAINST THE FEDERAL GOVERNMENT AND THOSE WITH WHOM IT DEALS

"[S]ince 1819, when Chief Justice Marshall in [*McCulloch* v. *Maryland*, 4 Wheat. 316] expounded the principle that properties, functions, and instrumentalities of the Federated Government are immune from taxation by its constituent parts, this Court never has departed from that basic doctrine or wavered in its application." *United States* v. *County of Allegheny*, 322 U.S. 174, 176. In determining the reach of that constitutional immunity, the Court has often considered whether property belonged to the United States under particular arrangements with

private parties or whether particular entities were federal instrumentalities. "But unshaken, rarely questioned * * * is the principle that possessions, institutions, and activities of the Federal Government itself in the absence of express congressional consent are not subject to any form of state taxation" (*id.* at 177). See also *Kern-Limerick, Inc.* v. *Scurlock*, 347 U.S. 110, 117-118; *Department of Employment* v. *United States*, 385 U.S. 355, 358-359; *Agricultural Bank* v. *Tax Commission*, 392 U.S. 339, 340; *United States* v. *Mississippi Tax Commission*, 421 U.S. 599, 612-613. Federal tax immunity is "the unavoidable consequence of that supremacy which the constitution has declared." *McCulloch* v. *Maryland*, *supra*, 4 Wheat. at 436.

Inherent in the *McCulloch* immunity principle is the well-established proposition that "a tax may be invalid even though it does not fall directly on the United States if it operates so as to discriminate against the Government or those with whom it deals." *United States* v. *City of Detroit*, 355 U.S. 466, 473. Accord: *Phillips Chemical Co.* v. *Dumas School District*, 361 U.S. 376, 385-387; *Moses Lake Homes* v. *Grant County*, 365 U.S. 744, 751.

We submit that the district court correctly held that the Montana contractors' gross receipts tax discriminates against the United States and those with whom it deals, and thus violated the Supremacy Clause of the Constitution. "The rule to be derived from the Court's more recent decisions * * * is that the economic burden on a federal function of a state

tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the State" (footnote omitted). *United States* v. *County of Fresno*, *supra*, 429 U.S. at 462. But, as we shall show, the Montana tax is not "imposed equally on other similarly situated constituents of the State" because it is not imposed on private contractors. It is imposed on federal contractors. Thus, its unconstitutionality is clearly established under the principles of *McCulloch* and *County of Fresno*.

A. Article VI of the Constitution provides that "[t]his Constitution, and the laws of the United States which shall be made in Pursuance thereof; * * * shall be the supreme law of the Land * * *." This principle of constitutional supremacy of the federal government was the basis of the Court's landmark decision in *McCulloch* v. *Maryland*, *supra*, which struck down a state tax upon the issuance of notes by the Bank of the United States.

In *McCulloch*, the State of Maryland imposed a tax on notes issued by "any Bank * * * established * * * without authority from the state" (4 Wheat. at 320). The only such bank in Maryland was the Bank of the United States, created and incorporated by Act of Congress. In holding that the tax violated the Supremacy Clause, the Court observed that the power to tax the bank "by the states may be exercised so as to destroy it" (*id.* at 427) and rejected the state's argument that the power to tax

was equivalent to the power to destroy only where the taxing power was abused. As the Court stated, "[w]hen [the people of a state] tax the chartered institutions of the states, they tax their constituents; and these taxes must be uniform. But, when a state taxes the operations of the government of the United States, it acts upon institutions created, not by their own constituents, but by people over whom they claim no control" (4 Wheat. at 435). Or as the Court put it most recently in explaining the *McCulloch* rationale, "the political check against abuse of the power to tax a State's constituents is absent when the State taxes only a federal function. A State's constituents can be relied on to vote out of office any legislature that imposes an abusively high tax on them. They cannot be relied upon to be similarly motivated when the tax is instead solely on a federal function" (footnote omitted) *United States* v. *County of Fresno*, 429 U.S. 452, 458-459.

McCulloch turns on the fact that the state had directly taxed an instrumentality of the United States. But if the State had taxed the property of private persons generally, such a tax could have constitutionally included notes of the Bank of the United States held by private persons. For the Court stated that its decision did not "extend to a tax * * * imposed on the interest which the citizens of Maryland may hold in this institution [the bank], *in common with other property of the same description throughout the state*" (emphasis added) (4 Wheat. at 436).

The teaching of *McCulloch* is therefore that a state cannot impose a tax directly upon the federal government. However, it may constitutionally impose a tax upon those who deal with the federal government as long as the tax is imposed equally on all those who stand in comparable economic positions within the state. In these circumstances, the broader class of taxpayers provides the United States with indirect political representation and establishes a political check against abuse of the taxing power that would otherwise be absent if the tax were limited to those who deal with the federal government. Thus, the taxation of similarly situated constituents within the state insures that the tax will not discriminate against the United States and those with whom it deals.

This reading of *McCulloch* was confirmed by the Court's recent decision in *United States* v. *County of Fresno*, *supra*. There, the Court upheld a county tax, authorized by state law, upon the possessory interests of those who leased federally-owned houses on tax-exempt land owned by the United States. This tax corresponded to the tax which the counties imposed on private realty, which was presumably reflected in the rent paid by private lessees.

In upholding the tax on the federal lessees, the Court reaffirmed the rationale of *McCulloch* that the states cannot impose a tax exclusively bearing on a federal function but that taxes bearing on both private and federal interests are subject to a "political check against abuse" (429 U.S. at 458) and are

therefore consistent with the policies underlying the Supremacy Clause. "So long as the tax is not directly laid on the Federal Government, it is valid if nondiscriminatory * * *." *Id.* at 460. Accord: *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 150 (gross receipts tax imposed on both private and public contractors). Thus, "the economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on the other similarly situated constituents of the state" (footnote omitted) (429 U.S. at 462). Since the California tax was on possessory interests of private persons in improvements on all types of exempt land, thereby including but not limited to land owned by the federal government, it did not threaten to destroy the federal function and therefore did not violate the Supremacy Clause (see *id.* at 463 n.11). Moreover, as the Court observed, California imposed a property tax on the owners of nonexempt property that is " 'passed on by them to their * * * lessees.' " Accordingly, the federal lessees were no worse off under California tax laws than those who rented houses in the private sector. *Id.* at 465. See also *United States* v. *City of Detroit*, *supra*, 355 U.S. at 473-474. However, if a comparable tax had not been reflected in the rent paid by private lessees, the tax at issue would have been invalid as to the federal lessees, for it would have "discriminate[d] against the Government or those with whom it deals." *Phillips Chemical Co.* v. *Dumas School Dist.*, *supra*, 361 U.S. at 387.

B. In light of the foregoing principles, the Montana gross receipts tax cannot constitutionally be applied to federal contractors. Pursuant to the statute, "each public contractor shall pay to the state an additional license fee * * * equal to one per cent * * * of the gross receipts from public contracts during the income year for which the license is issued * * * (Section 84-3505(5), J.S. App. 41). The term "public contractor" is defined to include "any person who submits a proposal to or enters into a contract for performing all public construction work in the state with the federal government, State of Montana, or with any other * * * public board, body, commission, or agency authorized to let or award contracts for any public work when the contract cost * * * exceeds * * *$1,000" (Section 84-3501, J.S. App. 38). By its terms, the tax applies to those contractors who perform services for the federal government. However, a contractor who performs the same services for a private party is not subject to the tax. Thus, the tax is not "imposed equally on the other similarly situated constituents of the State" (*United States* v. *County of Fresno*, *supra*, 429 U.S. at 462) because federal contractors are worse off than their counterparts who work in the private sector. Cf. *United States* v. *County of Fresno*, *supra*, 429 U.S. at 465. This discrimination in favor of private parties at the expense of the United States and those with whom it deals is barred by the Supremacy Clause.

Contrary to appellants' argument (Br. 34-35), the fact that the tax is imposed upon contractors who

deal with the federal, state and local governments does not alter the constitutional analysis. Under the teaching derived from *McCulloch*, a state cannot impose a tax that bears even indirectly upon the operations of the federal government unless it is even-handedly imposed upon *all* of its constituents engaged in identical activities. Here, the pertinent class of similarly situated constituents includes all contractors performing services for amounts that exceed $1,000, not simply those who work for the federal, state and local governments. There is accordingly no justification for excluding private contractors from the analysis when there is no discernible difference between their activities and those of federal contractors. Cf. *Halliburton Oil Well Co.* v. *Reily*, 373 U.S. 64, 71.[10] The policies underlying the

[10] In *Kiewit #1*, the Montana Supreme Court concluded that the statutory distinction between public and private contractors was constitutionally permissible because: (1) defective public works expose the public at large to danger; (2) public contractors must be experienced; (3) public contractors must provide a bond; and (4) public works usually involve elaborate professionally drawn plans and specifications and mandatory inspections (see J.S. App. 117-118). The court found that these factors justified different tax treatment under the Equal Protection Clause.

But it is well settled that the test as to whether a legislative classification is permissible under the Equal Protection Clause is not controlling where the immunity of the United States is involved. *Phillips Chemical Co.* v. *Dumas School Dist.*, *supra*, 361 U.S. at 385; *United States* v. *Allegheny County*, *supra*, 322 U.S. at 191. Indeed, apart from the State of New York (Br. 4-5), the appellants (Br. 39-40) and the other *amici* concede the correctness of this proposition. While the appellants (Br. 18-22, 29-30, 33-40) accuse the district court of confusing the immunity and equal protection issues,

Supremacy Clause demand that those who deal with the federal government be protected against the abuse of oppressive taxation by the imposition of an equal tax burden upon a sufficiently large class of private persons and entities. Under this standard, the Montana tax does not provide the requisite political protection to federal contractors and is therefore unconstitutional.

Appellants seek to distinguish the instant case from *McCulloch* by pointing out (Br. 34-35), as did the Montana Supreme Court in *Kiewit #1* (J.S. App. 121), that the tax is imposed not only on contractors for the federal government, but also on contractors for the state. But as the following example makes clear, the tax on state contractors is illusory and is

the court specifically stated that it was "unnecessary to pass upon the Equal Protection issues" (J.S. App. 15).

At all events, the distinctions proposed by the Montana Supreme Court in *Kiewit #1* have no bearing upon classification for tax purposes but simply go to whether a particular contractor is competent to perform services for a governmental body. See also J.S. App. 15-16. Indeed, the record in this case indicates that many contractors who perform work for private persons do so for governments as well (A. 94-95; I-Tr. 105, II-Tr. 320, III-Tr. 376; Pltf. Ex. 8). Moreover, many bulidings constructed by private contractors are leased to government users and thereby serve the general public (J.S. App. 16; A. 95-101, 108-111, 130-132, 181-185). There are accordingly no significant differences between public and private contractors that would warrant different tax treatment. While the State of New York (Br. 4-5) suggests that the distinction between public and private contractors is justified because it is easier to collect taxes from public contractors, the record does not support such an inference and the appellants do not assert this to be the case.

not sufficient to save the tax from unconstitutionality where a significant segment of similarly situated constituents, *i.e.*, private contractors, are exempt from the tax.

If a contractor working on a job for a private party buys a $100 bag of cement and pays a $1 tax on the purchase, the state gains $1 at the expense of the private party. If a contractor working on a contract for the state buys a $100 bag of cement and pays a $1 sales tax, the state reimburses him $101, and gains nothing. If a contractor on a federal job makes a similar purchase, the federal government reimburses him $101, and the state gains $1 at the expense of the federal government. The state is, in a sense, treating itself better than the federal government, because it pays no tax and the federal government does; however, the tax is nondiscriminatory because the federal government is treated exactly like the private party. Thus the tax would not violate the Supremacy Clause under the *McCulloch* and *County of Fresno* rationale. Because the state legislature will presumably not impose oppressive taxes on its citizens, any tax which puts persons who deal with the federal government to the same burden as the state's citizens generally is constitutional. The fact that the state "pays" no tax is irrelevant; the non-payment simply reflects the fact that the state is transferring money from its left pocket (the contracting office) to its right pocket (the tax collector).

But cf. *United States* v. *County of Fresno*, *supra*, 429 U.S. at 474 n.10 (Stevens, J., dissenting).

If, as in the instant case, the tax on private parties is eliminated in the example, the discrimination against the federal government becomes apparent. The private party pays no tax; the state pays no tax; only the federal government pays the tax. There is no political check to prevent the legislature from raising the tax to oppressive levels and thereby impede the functioning of the federal government. Its citizens will not protest and the state, though it transfers larger amounts of money from pocket to pocket, in the end pays nothing. The federal government pays the tax to the state through its contractors, and the discriminatory effect is clear. The tax is invalid under the Supremacy Clause.

It is therefore evident that the tax on private parties offers the only meaningful protection to the federal government against discrimination. Once the tax on private parties is eliminated, the federal government stands alone as a true taxpayer to the state. The state's claim that its own contractors must also pay the higher tax is illusory; whatever the contractors pay to the state is reimbursed by the state and, no matter how high the tax, the state pays it from one pocket to another.

In sum, the tax in this case is not imposed on private parties. It is imposed only on contractors for the federal government and, ostensibly, on contrac-

tors for the state. Because Montana does not, as a practical matter, pay a tax to itself, the fact that the tax is nominally "imposed" on state contractors is immaterial.

This leaves only the matter of credits. The credits work here to allow a contractor, first, to take a credit for the amount of his personal property tax against the gross receipts tax. Then, the contractor may credit the balance of the gross receipts tax against his income tax. If the gross receipts tax was eliminated by the credits for personal property and income taxes generated by the personal property used in and the income derived from performing the contract with the government, there would be in effect no gross receipts tax at all and no dispute. This, however, is not the case (J.S. App. 12-13, 92). The gross receipts taxes are only half consumed when they are applied to satisfy other taxes. Thus, over time, the effective rate of the gross receipts tax has been one-half of one percent. This is a small tax, but it is a real one. It is not paid by private parties. This one-half of one percent is not paid in any real sense by the state.[11] It is paid by the federal government.

[11] To the extent of the personal property tax credit, the gross receipts tax represents a cost to the state for its construction (A. 87-88, 90-91). This credit, however, represents only part of the gross receipts tax (J.S. App. 92). The balance of the tax, in reality, represents no cost to the state (J.S. 13). Accordingly, the presence of this credit for personal property tax does not detract from our argument that the tax discriminates against the federal government. See *Moses Lake Homes* v. *Grant County, supra.* Compare *Offutt Housing Co.* v. *Sarpy County,* 351 U.S. 253.

It is therefore discriminatory and cannot stand under the Supremacy Clause.

C. *Phillips Chemical Co.* v. *Dumas School Dist., supra,* upon which the appellants (Br. 30-33) rely, is not to the contrary; indeed it supports the position of the United States. In that case, the State of Texas taxed lessees of federal property at a higher rate than it taxed lessees of state property. In striking down the tax, the Court observed that "it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself" (361 U.S. at 385). The Court found the special Texas tax for federal lessees invalid because "it still remains true, as it has from the time of *McCulloch* v. *Maryland,* 4 Wheat. 316, that a state tax may not discriminate against the Government or those with whom it deals" (*id.* at 387).

Appellants argue (Br. 31-32) that *Phillips Chemical* requires only that, in taxing those with whom the federal government deals, the state must treat such persons "as well as it treats those with whom [the state] deals itself" (361 U.S. at 385). Focusing on this language, appellants urge that the Montana tax is valid because it is imposed on both federal and state contractors. But as we have shown *supra,* pp. 23-25, the burden of the tax falls on the federal government and not on the state government. At all events, even on the assumption that federal and state contractors are treated equally, the tax would still be invalid

under *Phillips Chemical* because of the exemption for private contractors. Indeed, in analyzing the Texas tax, the Court specifically noted that "there appears to be no discrimination between the Government's lessees and lessees of private property" (*id.* at 381). Thus, *Phillips Chemical* announced no new test of discrimination, much less a test that could be satisfied by the Montana statute. It explicitly adhered to the principles formulated by this Court in *McCulloch* and reaffirmed in *County of Fresno*—if the tax discriminates against the federal government or those with whom it deals, the tax is invalid. Since the Montana tax treats private contractors more favorably than federal contractors, it offends the Supremacy Clause.

D. Appellants (Br. 16-17, 36-39) and the *amici* (Wash. Br. 14-15; Va. Br. 6) further contend that the imposition of the Montana tax upon gross receipts from local governments saves its constitutionality. But the fact that the tax is imposed on receipts from local governments, school districts and other governmental entities makes no difference, even on the assumption that those entities, like the federal government, cannot recover the payments occasioned by the tax (see J.S. App. 12). Once it is shown that the tax discriminates against the federal government by favoring similarly situated constituents within the state, the tax must fall; its constitutionality cannot be restored by showing that the state also discriminates against other governmental entities. For purposes of the Supremacy Clause, one discrimination cannot serve to justify another discrimination

against the federal government and those with whom it deals.

Finally, appellants (Br. 16, 33) and the *amici* (Wash. Br. 17-19; Va. Br. 4-8) argue, as the dissenting judge below stated, that the federal government's reasoning "if followed to its logical conclusion" would effectively invalidate state gross receipts taxes upon all contractors, or sales taxes imposed upon all purchasers of goods, which taxes were upheld in *Alabama* v. *King & Boozer*, 314 U.S. 1; in *James* v. *Dravo Contracting*, *supra*; and in *Mason Co.* v. *Tax Commission*, 302 U.S. 186 (see J.S. App. 28). The short answer is simply that, for the reasons shown above, the reasoning is not carried "to its logical conclusion." Taxes such as those in *King & Boozer*, *Dravo Contracting*, *Mason Co.*, as well as in *United States* v. *Boyd*, 378 U.S. 39, are valid, even when imposed on those who deal with the federal government, because they are not discriminatory under the standard established in *McCulloch* and *County of Fresno*. They are imposed equally on all similarly situated (private as well as governmental) contractors in the state. The tax involved here is not.

II.

THE DECISION OF THE MONTANA SUPREME COURT IN *KIEWIT #1* DOES NOT BAR THE UNITED STATES FROM CHALLENGING THE CONSTITUTIONALITY OF THE TAX IN THIS CASE

The district court also correctly held that the United States is not barred by the decision of the

Montana Supreme Court in *Kiewit #1* from challenging the constitutionality of the tax in this case.

Appellants advance two separate arguments in support of a bar against reaching the merits. First, they contend (Br. 42-45) that the district court had no jurisdiction under the rule of *England* v. *Medical Examiners*, 375 U.S. 411. Second, they invoke (Br. 46-49) the doctrine of collateral estoppel as a bar to the federal government's claim. We submit that neither *England* nor collateral estoppel is applicable here.

A. In *England*, the plaintiff brought an action in the federal district court challenging the constitutionality of a state statute. The district court invoked, *sua sponte*, the doctrine of abstention on the ground that a state court might rule that the plaintiffs were not governed by the statute and thereby avoid a constitutional determination. The district court therefore stayed further proceedings until the state courts could consider the state law. The plaintiffs thereupon brought suit in the state court but did not restrict those proceedings to the state law question. To the contrary, "[t]hey unreservedly submitted for decision, and briefed and argued, their contention that the Act, if applicable to [them], violated the Fourteenth Amendment" (footnote omitted) (375 U.S. at 413). After the state courts ruled against them, the plaintiffs returned to the district court which dismissed their action because the state courts passed on all issues raised.

This Court held "that if a party freely and without reservation submits his federal claims for decision by the state courts, litigates them there, and has them decided there, then—whether or not he seeks direct review of the state decision in this Court—he has elected to forgo his right to return to the District Court" (*id.* at 419). In so holding, the Court observed that a party is not required to litigate his federal claims in the state courts. However, if the federal court abstains, either party may inform the state courts that he intends, should the state courts hold against him on the question of state law, to return to the district court for disposition of his federal contentions (*id.* at 421). An explicit reservation is not required. As the Court explained, "the litigant is in no event to be denied his right to return to the District Court unless it clearly appears that he voluntarily did more than [inform the state courts of his federal claims] and fully litigated his federal claims in the state courts" (*ibid.*).

England therefore stands for the proposition that parties who initially present their federal claims to a federal court cannot litigate those issues in that court where (1) the federal court abstains and sends the parties to state court for a resolution of state law grounds, (2) those parties "freely and without reservation" litigate all their claims in the state courts, (3) the parties in the federal and state court actions are identical, and (4) the state court has competent jurisdiction over the parties. These conditions are not met in the instant case.

First, the district court never invoked the doctrine of abstention. The parties to this litigation merely

agreed to continue the case while the state courts considered *Kiewit #1*, in which the federal government appeared as *amicus curiae*. In response, appellants argue (Br. 43-44) that whether the order is characterized as a continuance or abstention is of no moment because it was the intent of the parties to have the *Kiewit #1* litigation resolve the constitutionality of the Montana tax. But neither the stipulation (J.S. App. 49-50) nor the order of continuance (J.S. App. 50-51) supports appellants' view of the matter. To the contrary, these documents simply recite that the federal court case is to be continued "pending the resolution in the state courts of Montana" (J.S. App. 49, 50) of *Kiewit #1*. Thus, this case is not comparable to the traditional abstention situations where the parties to a federal action repair to the state court for an adjudication of state law in the same case that may obviate the need for a resolution of the federal claims, or where there are difficult questions of state law best resolved by a state court. Here, the parties simply agreed to suspend proceedings pending the outcome of a previously pending separate state court litigation brought by another party, *viz.*, Kiewit Sons' Company.[12] That case did not involve resolution of any state law ques-

[12] That the parties intended the federal district court to consider independently the merits of the case is further demonstrated by the provisions in the stipulation and order relating to disbursement of the fund and interest accruing from the taxes depending upon which party prevailed "in the above entitled action" (J.S. App. 50, 51).

tions that might avoid consideration of the federal constitutional immunity claims present here.

The result in *Kiewit #1* therefore represents nothing more than a related precedent to be taken into account; it does not control this case, much less bar the United States from having its day in the federal district court. Since abstention is not applicable, this case falls within the general rule that "the pendency of an action in the state court is no bar to proceedings concerning the same matter in the Federal court having jurisdiction * * *." *McClellan* v. *Carland*, 217 U.S. 268, 282. The postponement of proceedings in this case by mutual consent of the parties does not rob the district court of jurisdiction. As the Court stated in *England* v. *Medical Examiners*, *supra*, 375 U.S. at 415, "[t]here are fundamental objections to any conclusion that a litigant who has properly invoked the jurisdiction of a Federal District Court to consider federal constitutional claims can be compelled, without his consent and through no fault of his own, to accept instead a state court's determination of those claims" (footnote omitted). Accord, *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185, 188-189.

Second, in agreeing to the continuance, the United States never "freely and without reservation" submitted its claims to the state court. Appellants allege that (Br. 44-45) the cooperation between the federal government and the plaintiff-contractor in *Kiewit #1* and the similarity of the complaints in both cases is evidence that the United States freely submitted

its claims to the courts of Montana. But the rule of *England* becomes applicable only when "a *party* freely and without reservation submits his federal claims for decision by the state courts * * *" (emphasis supplied) (375 U.S. at 419). The Court's reference to a "party" is not accidental for the bar of the *England* rule arises only upon the issuance of a valid state court judgment that binds the party seeking to invoke the jurisdiction of the federal district court. Here, the state courts in *Kiewit #1* never acquired jurisdiction over the federal government which appeared as *amicus*; the United States is therefore not bound by the judgment in that case. Indeed, in this action, the federal government seeks a determination of the constitutionality of the Montana tax with respect to all of its contracts. *Kiewit #1*, however, involved only one type of contract that is no longer employed. See p. 7, n. 7, *supra*. Thus, the judgment of the federal district court below does not undermine the "regard for the respective competence of the state and federal court systems" that lies at the heart of the abstention doctrine. *Louisiana P. & L. Co.* v. *Thibodaux City*, 360 U.S. 25, 29. The rule in *England* therefore did not prevent the district court from reaching the merits of this case.[13]

[13] Cf. *Colorado River Water Cons. Dist.* v. *United States*, 424 U.S. 800. There, although the case fell within none of the abstention categories, the Court upheld the dismissal of a federal suit where there was a concurrent state court proceeding. However, the decision turned on the particular policy against piecemeal litigation of water rights evidenced by the consent to state court jurisdiction over the United States provided by the McCarran amendment, 43 U.S.C. 666 (424 U.S. at 819-821). Those considerations do not apply here where the United States was not a party to the state proceeding and where constitutional issues are presented.

B. Nor does the doctrine of collateral estoppel bar the United States from litigating the merits of its claim. The usual statement of the rule is that where an issue of fact, or in limited situations an issue of law "essential to the judgment, is actually litigated and determined by a valid and final judgment, the determination is conclusive between the parties * * *." A.L.I., *Restatement of Judgments* § 68(1) (1942). The doctrine "must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged." *Commissioner* v. *Sunnen*, 333 U.S. 591, 599-600. See also 1B Moore's *Federal Practice*, pars. 0.443, 0.448 (2d ed. 1974).

Here, the controlling facts changed between *Kiewit #1* and the instant case. As we have pointed out (*supra*, pp. 7-8), the contract at issue in *Kiewit #1* forbade the contractor from claiming the credit and refund provisions of the gross receipts tax. This provision is no longer applicable in the contracts involved in this litigation.

The decision in *Kiewit #1*, moreover, did not determine the issue here. Because of the amount of heavy equipment that Kiewit employed in Montana, it was not established that the gross receipts tax here

in question would have imposed any financial burden upon the contractor. Had it claimed the credit, it appeared that Kiewit's personal property tax would have eliminated all of the public contractor's gross receipts tax. Indeed, the Montana Supreme Court proceeded upon the assumption that there might in all cases be "a total washout of the 1% gross receipts payments" (J.S. App. 109, 111-113). Though Kiewit might have been relieved of all of the public contractor's tax had it claimed the available credit, and though the Supreme Court of Montana was uncertain of the ultimate fiscal impact of the tax, the record in this case establishes that with respect to its contractors, the effective rate of the tax borne ultimately by the United States, after taking all credits available, will be approximately one-half of one percent of gross receipts (J.S. App. 11, 87-88). Thus, the factual assumption upon which *Kiewit #1* rests is lacking in this case.

CONCLUSION

The judgment of the district court should be affirmed.

Respectfully submitted.

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